

This month Home Truths divides New Zealand's housing market in three, while taking issue with the most popular explanation of rising prices in Auckland. But first, we review the latest nationwide data.

The number of house sales in New Zealand rose just 0.2% in the month of June, having fallen 5.6% in the previous two months. However, prices rose another 0.3% to be 8.4% higher than a year ago - see the table below.

## REINZ housing data

	Jun-13	May-13	Jun-12
<b>House sales, number, s.a.</b>	6492	6479	6086
Mth % chg	0.2	-4.8	-1.3
Ann % chg	0.0	7.5	17.3
<b>Days to sell, sa</b>	33.0	33.6	35.8
<b>House Price Index (s.a.)</b>	3679.5	3667.0	3394.9
Mth % chg	0.3	0.5	0.7
Ann % chg	8.4	8.7	5.3

In normal circumstances, we would suggest that falling turnover is a harbinger of slacker price action to come. However that may not be true on this occasion. Right now, a lack of houses for sale is crimping turnover. The market is tight as a tourniquet. The number of days taken to sell a house is hovering at the lowest levels since 2007. Last week an Auckland agency's report showed that it had just 2.8 months' worth of sales listed on the market - the lowest figure on record. And anecdotes abound of frustrated buyers crowding into open homes and bidding frantically.

Of course, one cannot really talk of a single "New Zealand" housing market. We have become one nation with three separate housing markets, each behaving completely differently from the others. Recent data has, if anything, deepened the distinction between those three markets.

In the half of New Zealand outside Canterbury and Auckland, market turnover is average, house price inflation is running in the low to mid single digits, and rents are pretty much flat.

Canterbury is a market with a physical lack of houses on the ground. House prices are rising at an annual pace of 11%, and rents are rising at 12% per annum. It makes sense that rents would rise faster than house prices in a market with a temporary shortage. Those looking to buy may be wary of overpaying because they know additional housing supply will come on stream in the future. It is important to remember that houses are long-lived assets, so the price people are willing to pay depends upon their expectations of the future. No such consideration exists in the market for renting. Rental contracts are for short terms only and therefore future building activity has little bearing on today's price. Temporary shortages can lead to higher rents.

The Auckland market is different from most of New Zealand, and is different again from Christchurch. It has become fashionable to talk about a physical shortage of houses and slow building activity driving prices higher in Auckland. **But physical housing shortages cannot explain the fact that rents are falling in Auckland.** House prices in Auckland are now rising at almost 20% per annum, while rents actually fell 1% in the year to May 2013, according to the Ministry of Business, Innovation and Employment. If physical supply was desperately falling short of demand, rents would be rising alongside house prices like they are in Canterbury. Physical supply shortages simply do not fully explain the Auckland housing market.

A better explanation for the characteristics of Auckland's housing market - low turnover, rapid sales, rising prices, falling rents - is **widespread expectation of future capital gain.** Owners are reluctant to sell because they expect better prices in the future, hence low turnover. Buyers are desperate to get in and enjoy capital gains, hence rapid sales and rising prices. Investors are keen to acquire properties despite low rental returns, hence falling rents. Tenants would rather own, again pointing in the direction of falling rents and rising prices.

As to why there exists a widespread expectation of capital gain in Auckland, three candidate explanations spring to mind:

- People believe that Auckland's population and incomes will grow rapidly while insufficient houses will be permitted, creating a future sharp increase in rents that restores balance.
- People believe that today's low interest rates will last forever, thus allowing future generations to pay more for houses despite low rental yields.
- The expectation is irrational (a bubble).

If physical shortages are not the main explanation for the behaviour of Auckland's housing market, then building more houses will not necessarily change the market. I seriously doubt that the supply measures recently enacted by the Government will really change much. Prices are being driven by buyer expectations of future capital gain - we know this because prices have become divorced from rents. The key to changing the trajectory of prices is to change buyer expectations.

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